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WILLIAM A. MUNDELL

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IN THE MATTER OF THE GENERIC)
PROCEEDINGS CONCERNING ELECTRIC)
RESTRUCTURING ISSUES)

DOCKET NO. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC)
SERVICE COMPANY'S REQUEST FOR)
VARIANCE OF CERTAIN REQUIREMENTS)
OF A.A.C. R14-2-1606)

DOCKET NO. E-01345A-01-0822

IN THE MATTER OF THE GENERIC)
PROCEEDING CONCERNING THE)
ARIZONA INDEPENDENT SCHEDULING)
ADMINISTRATOR)

DOCKET NO. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC)
POWER COMPANY'S APPLICATION FOR)
A VARIANCE OF CERTAIN ELECTRIC)
COMPETITION RULES COMPLIANCE)
DATES)

DOCKET NO. E-01933A-02-0069

IN THE MATTER OF THE APPLICATION)
OF TUCSON ELECTRIC POWER COMPANY)
FOR APPROVAL OF ITS STRANDED COST)
RECOVERY)

DOCKET NO. E-01933A-98-0471

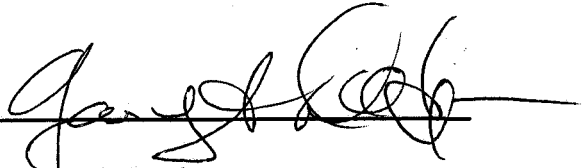
**SUMMARY OF DIRECT AND
REBUTTAL TESTIMONY OF
ARIZONANS FOR
ELECTRIC CHOICE
AND COMPETITION**

Arizonans for Electric Choice and Competition (AECC) hereby submits the

Summary of the Direct and Rebuttal Testimony of Kevin C. Higgins in the "Track A"

portion of the above-captioned proceedings.

1 RESPECTFULLY SUBMITTED this 18th day of June, 2002.

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4 Gary A. Dodge
5 Attorney for Arizonans for Electric Choice
6 and Competition
7 10 West Broadway, Suite 400
8 Salt Lake City, UT 84101
9 (801) 363-6363 - telephone
10 (801) 363-6666 - facsimile
11 gdodge@hjdllaw.com - email
12
13
14

15 Original and eighteen (18) copies of the foregoing
16 filed this 18th day of June, 2002, with:

17
18 Docket Control Division
19 Arizona Corporation Commission
20 1200 West Washington Street
21 Phoenix, Arizona 85007
22

23 Copies of the foregoing were mailed/delivered this 18th day of June 2002 to the attached
24 service list.

SUMMARY OF TESTIMONY KEVIN C. HIGGINS

Direct Testimony

In my direct testimony I make the following points:

1. On behalf of AECC, I was closely involved in the negotiations that resulted in the APS and TEP Settlement Agreements.
2. AECC reaffirms its strong support for the APS and TEP Settlement Agreements, which provide both short-term and long-term benefits for Arizona customers.
3. AECC recognizes that, these agreements notwithstanding, the Commission must be assured that, on a going-forward basis, the structure of the Arizona power market is in the public interest.
4. In my view, the most critical public interest issue to be addressed on a going-forward basis is that of potential market power, which I believe can and should be addressed within the context of the Settlement Agreements.
5. Market power in the Phoenix, Tucson, and Yuma load pockets is addressed in the "must-run generation" protocol of the Arizona ISA – as directed by the Commission in the Electric Competition Rules. This stakeholder-negotiated, FERC-approved protocol requires that during load pocket conditions, generation owners inside the load pocket must sell to scheduling coordinators, on a cost-of-service basis, sufficient generation beyond the amount of the transmission import constraint to serve load inside the load pocket.
6. After the Arizona ISA is replaced by an RTO, responsibility for mitigating market power in load pockets should be addressed by the RTO tariff in a manner that protects retail customers while providing transmission owners and generators the necessary long-term incentives to alleviate the load pocket problem. The load pocket treatment filed at FERC by WestConnect is similar to that of the Arizona ISA, but allows local generation owners to sell at market prices (established outside the load pocket) during load pocket conditions and attempts to establish a framework for creating proper incentives for generation to be constructed inside the load pocket.
7. The approaches to mitigating load-pocket market power provided in both the Arizona ISA Tariff and the WestConnect filing are reasonable and well-balanced mechanisms.
8. The Commission and other Arizona stakeholders should become actively involved before FERC to ensure that rigorous procedures are put in place to test for and, if necessary, to mitigate any wholesale market power that might arise in a post-divestiture Arizona. While FERC's past record in addressing horizontal market power issues has been controversial and the target of significant criticism, market power is now clearly a "front-burner" issue at FERC, and it is receiving, and will continue to receive, a great deal more scrutiny.
9. FERC has moved toward more rigorous testing of market power potential, namely the Supply Margin Assessment (SMA) test, which indicates the presence of

- market power if a single seller controls an amount of generation that exceeds the market's supply margin (generation in excess of load) during peak demand.
10. My recommendation is that a similar, but more comprehensive test, called the Residual Supply Index (RSI) screen, should be applied to APS and its affiliates and TEP and its affiliates, with respect to each utility's territory. The RSI screen calculates, for each hour of the year, the ratio of residual supply (total supply minus the capacity of the supplier in question) to system demand (load plus reserve). When the RSI is significantly above 100 percent, there is sufficient supply in the market to support competitive prices even if the supplier in question withholds all of its capacity. However, if the RSI is below 100 percent (or not significantly above 100 percent), then potential market power is indicated for the supplier in question, and mitigation measures are in order.
 11. If the RSI screen (or other appropriate test) indicates that generalized market power is present in either the APS or TEP territories, then some type of capped pricing – either tied to cost-of-service or an external market index – combined with a “must-offer” obligation, should be required for the hours in which market power was indicated.
 12. Because power markets are dynamic, it is important that potential market power be subject to continuous scrutiny by an entity with region-specific expertise. FERC will require this market monitoring function to be performed by RTOs. I recommend that the Commission become closely involved in the development of the market monitoring procedures of WestConnect (or alternative RTO with responsibility for Arizona) to ensure that potential market power in Arizona is carefully monitored and appropriately mitigated.

Rebuttal testimony

In my rebuttal testimony, I offer the following points of rebuttal to the direct testimony of TEP witness James S. Pignatelli:

1. Mr. Pignatelli's proposal to exclude all customers with loads of 3 MW or less from direct access should be rejected. His proposal would abrogate TEP's commitments under its Settlement Agreement, which ensures direct access rights for *all* TEP customers.
2. In addition to direct access rights, TEP customers are assured of stable rates through the end of 2008 by virtue of the Settlement Agreement.
3. Mr. Pignatelli's proposal to abrogate direct access rights for the vast majority of TEP customers is a blatant attempt by a signatory to an agreement to advance its pre-settlement objectives in contravention of its settlement commitments, while offering absolutely nothing in exchange.
4. If AECC were to emulate TEP's strategy of lobbying for after-the-fact changes to the settlement, AECC would seek changes in the “Adders” used in the determination of the shopping credit in TEP's territory. As it is, these Adders are open to reconsideration in 2004. I view Mr. Pignatelli's proposal to eliminate direct access of most of its customers to be an opportunistic, preemptive strike against having the Adders adjusted upward in 2004.

Walter W. Meek
Arizona Utility Investors Assoc.
2100 N. Central Avenue, #210
Phoenix, AZ 85004

RICK GILIAM
ERIC C. GUIDRY
Land & Water Fund of the Rockies
2260 Baseline Road, #200
Boulder, CO 80302

TERRY FROTHUN
Arizona State AFL-CIO
5818 N. 7th Street, #200
Phoenix, AZ 85014-5811

NORMAN J. FURUTA
Department of the Navy
900 Commodore Drive, Bldg. 107
San Bruno, CA 94066-5006

BARBARA S. BUSH
Coalition for Responsible Energy
Education
315 W. Rivera Drive
Tempe, AZ 85252

SAM DEFRAW (Attn. Code 001)
Rate Intervention Division
Naval Facilities Engineering Command
Building 212, 4th Floor
901M Street
Washington, DC 20374-5018

RICK LAVIS
Arizona Cotton Growers Assoc.
4139 East Broadway Road
Phoenix, AZ 85040

STEVE BRITTLE
Don-T Waste Arizona, Inc.
6205 South 12th Street
Phoenix, AZ 85040

Columbus Electric Cooperative, Inc.
P. O. Box 631
Deming, NM 88031

Continental Divide Electric Coop.
P. O. Box 1087
Grants, NM 87020

Dixie Escalante Rural Electric Assoc.
CR Box 95
Beryl, UT 84714

Garkane Power Association, Inc.
P. O. Box 790
Richfield, UT 84701

Arizona Dept. of Commerce
Energy Office
3800 North Central Ave., 12th Floor
Phoenix, AZ 85012

CHRISTOPHER J. EMGE
Arizona Community Action Assoc.
2627 N. 3rd Street, #2
Phoenix, AZ 85005

Tucson Electric Power Co.
Legal Dept. - DB203
220 W. 6th Street
P. O. Box 711
Tucson, AZ 85702-0711

JESSICA YOULE
PAB300
Salt River Project
P. O. Box 52025
Phoenix, AZ 85072-2025

JOE EICHELBERGER
Magma Copper Company
P. O. Box 37
Superior, AZ 85273

Craig Marks
Citizens Utility Company
2901 N. Central Avenue, Suite 1660
Phoenix, Arizona 85012-2736

Barry Huddleston
Destec Energy
PO Box 4411
Houston, Texas 77210-4411

Steve Montgomery
Johnson Controls
2032 West 4th Street
Tempe, Arizona 85281

Peter Glaser
Shook, Hardy & Bacon, L.L.P.
600 14th Street, N.W., Suite 800
Washington, D.C. 20005-2004
202-783-8400
202-783-4211 - F

Clara Peterson
AARP
HC 31, Box 977
Happy Jack, Arizona 86024

Jim Driscoll
Arizona Citizen Action
5160 E. Bellevue Street, Apt. 101
Tucson, Arizona 85712-4828

Larry McGraw
USDA-RUS
3266 Weeping Willow
Rio Rancho, New Mexico 87124

John Jay List
General Counsel
National Rural Utilities Cooperative Finance Corp.
2201 Cooperative Way
Herndon, Virginia 21071

Robert Julian
PPG
1500 Merrell Lane
Belgrade, Montana 59714

C. Webb Crockett
Jay L. Sharpiro
Fennemore Craig PC
3003 N. Central Avenue, Suite 2600
Phoenix, AZ. 85012-2913

Robert S. Lynch
340 East Palm Lane, Suite 140
Phoenix Arizona 85004-4529

K.R. Saline
K.R. Saline & Associates
Consulting Engineers
160 North Pasadena, Suite 101
Mesa, AZ 85201-6764

Carl Robert Aron
Executive Vice President & COO
ITRON Inc.
2818 N. Sullivan Road
Spokane Washington 99216

Douglas Nelson
Douglas C. Nelson PC
7000 N. 16th Street, Suite 120-307
Phoenix, AZ 85020-5547

Lawrence V. Robertson Jr.
Munger Chadwick, PLC
333 North Wilmot, Suite 300
Tucson, AZ 85711-2634

Albert Sterman
Arizona Consumers Council
2849 East 8th Street
Tucson, AZ 85716

Michael Grant
Gallagher & Kennedy
2575 East Camelback Rd.
Phoenix, AZ 85016-9225

Suzanne Dallimore
Antitrust Unit Chief
Department of Law Building
Arizona Attorney General's Office
1275 W. Washington Street
Phoenix, AZ 85007

Vinnie Hunt
City of Tucson
Department of Operations
4004 South Park Avenue, Building 2
Tucson, AZ 85714

Elizabeth S. Firkins
International Brotherhood of Electrical Wkrs
LU #1116
750 S. Tucson Blvd.
Tucson, AZ 85716-5698

Carl Dabelstein
2211 E. Edna Avenue
Phoenix, AZ. 85022

Roderick G. McDougal
City of Phoenix
Attn: Jesse Sears
200 W. Washington St. Suite 1300
Phoenix AZ 75003-1611

William J. Murphy
City of Phoenix
200 W. Washington St. Suite 1400
Phoenix, AZ 85003-1611

Russell E. Jones
Waterfall Economidis Caldwell Hanshaw &
Villamana PC
5210 E. Williams Circle, Suite 800
Tucson, AZ 85711

Christopher Hitchcock
Hitchcock & Hicks
PO Box 87
Bisbee, AZ 85603-0087

Andrew Bettwy
Debra Jacobsen
Southwest Gas Corporation
5241 Spring Mountain Rd.
Las Vegas, NV 89150-0001

Donna M. Bronski
City of Scottsdale
City Attorney's Office
3939 N. Drinkwater Blvd.
Scottsdale, AZ 85251

Bradford A Borman
PacifiCorp
201 S. Main, Ste. 2000
SLC, UT 84140

Timothy M. Hogan
Arizona Center for Law in the Public Interest
202 E. McDowell Rd. Suite 153
Phoenix, AZ. 85004

Marcia Weeks
18970 N. 116th Lane
Surprise, AZ 85374

John T. Travers
William H. Nau
272 Market Square, Ste 2724
Lake Forest, Ill 60045

Timothy Michael Toy
Winthrop Stimson Putnam & Roberts
One Battery Park Plaza
NYC, NY 10004-1490

Billie Dean
AVIDD
PO Box 97
Marana, AZ 85652-0987

Raymond B. Wuslich
Winston & Strawn
1400 L. Street, NW
Washington DC 20005

Steven C. Gross
Porter Simon
40200 Truckee Airport Rd.
Truckee, CA 96161-3307

Donald R. Allen
John P. Coyle
Duncan & Allen
1575 Eye Street, NW Suite 300
Washington, DC 20005

Ward Camp
Phaser Advanced Metering Services
400 Gold SW, Ste. 1200
Albuquerque, NM 87102

Theresa Drake
Idaho Power Company
PO Box 70
Boise, ID 83707

Libby Brydolf
California Energy Markets Newsletter
2419 Bancroft Street
San Diego, CA 92104

James P. Barlett
5333 N. 7th Street, Suite B-215
Phoenix, AZ 85014

Jay Moyes
Moyes Storey
3003 N. Central Ave., Suite 1250
Phoenix, AZ. 85012

Stephen L. Teichler
Stephanie A. Conaghan
Duane Morris & Heckscher, LLP
1667 K Street NW, Suite 700
Washington DC 20006

Kathy T. Puckett
Shell Oil Company
200 N. Dairy Ashford
Houston, TX 77079

Andrew N. Chau
Shell Energy Services Co. LLC
1221 Lamar, Suite 1000
Houston, TX 77010

Peter Q. Nyce Jr.
Department of the Army
JALS-RS Suite 713
901 N. Stuart Street
Arlington, Virginia 22203-1837

Michelle Ahlmer
Arizona Retailers Association
224 W. 2nd Street
Mesa, AZ 85201

Dan Neidlinger
Neidlinger & Associates
3020 N. 17th Drive
Phoenix, AZ 85015

Chuck Garcia
PNM, Law Department
Alvarado Square MS 0806
Albuquerque, NM 87158

Sanford J. Asman
570 Vinington Ct.
Dunwoody, GA 30350-5710

Patricia Cooper
AEPCO/SSWEPCO
1000 S. Highway 80
Benson, AZ 85602

Holly E. Chastain
Schlumberger Resource Management Services
Inc.
5430 Metric Place
Norcross, GA 30092-2550

Leslie Lawner
Enron Corp.
712 N. Lea
Roswell, NM 88201

Alan Watts
Southern California Public Power Agency
529 Hilda Ct.
Anaheim, CA 92806

Frederick M. Bloom
Commonwealth Energy Corporation
15991 Red Hill Ave. Suite 201
Tustin, CA 92780

Margaret McConnell
Maricopa Community College
2411 W. 14th Street
Tempe, AZ 85281-6942

Brian Soth
Firstpoint Services Inc.
1001 SW 5th Ave. Suite 500
Portland, Oregon 97204

Ian Calkins
Phoenix Chamber of Commerce
201 N. Central Ave. 27th Floor
Phoenix, AZ 85073

Kevin McSpadden
Milbank Tweed Hadley & McCloy, LLP
601 S. Figueroa. 30th Floor
LA, CA 90017

MC Arendes, Jr.
C3 Communications Inc.
2600 Via Fortuna, Suite 500
Austin Texas 78746

Patrick J. Sanderson
Arizona Independent Scheduling
Administrator Association
PO Box 6277
Phoenix, AZ 85005-6277

Roger K. Ferland
Quarles & Brady Striech Lang LLP
Renaissance One
Two North Central Avenue
Phoenix, AZ 85004-2391

Charles T. Stevens
Arizonians for Electric Choice & Competition
245 W. Roosevelt
Phoenix, AZ 85003

Mark Sirois
Arizona Community Action Assoc.
2627 N. Third Street, Suite 2
Phoenix, AZ 85003

Jeffery Guldner
Thomas L. Mumaw
Snell & Wilmner
400 E. Van Buren
One Arizona Center
Phoenix, AZ 85004-0001

Steven J. Duffy
Ridge & Isaacson PC
3101 N. Central Ave. Suite 740
Phoenix, AZ 85012

Greg Patterson
5432 E. Avalon
Phoenix, AZ 85018

Steven Lavigne
Duke Energy
4 Triad Center, Suite 1000
SLC, UT 84180

Dennis L. Delaney
K.R. Saline & Associates
160 North Pasadena, Suite 101
Mesa, AZ 85201-6764

Michael Kurtz
Borhm, Kurtz, & Lowry
36 E. Seventh Street, Suite 2110
Cincinnati, Ohio 45202

David Berry
PO Box 1064
Scottsdale, AZ 85252

William P. Inman
Dept. of Revenue
1600 W. Monroe, Rm 911
Phoenix, AZ 85020-5270

Jana Van Ness
APS
Mail Station 9905
PO Box 53999
Phoenix, AZ 85072-3999

David Couture
TEP
4350 E. Irvington Rd.
Tucson, AZ 85714

Jana Brandt
SRP
Mail Station PAB211
PO Box 52025
Phoenix, AZ 85072-2025

Randall H. Warner
Jones Skelton & Hochuli PLC
2901 N. Central Avenue, Suite 800
Phoenix, AZ 85012

John A. Lasota Jr.
Miller Lasota & Peters, PLC
5225 N. Central Ave., Suite 235
Phoenix, AZ 85012

Christopher Kempley, Chief Counsel
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, AZ 85007

Arizona Reporting Service Inc.
2627 N. Third Street, Suite three
Phoenix, AZ 85004-1104

Michael A. Curtis
William P. Sullivan
Paul R. Michaud
Martinez & Curtis PC
2712 North 7th Street
Phoenix, AZ 85006

Lindy Funkhouser
Scott S. Wakefield
RUCO
2828 N. Central Ave. Suite 1200
Phoenix, AZ 85004

Aaron Thomas
Vice President
AES NewEnergy Inc.
350 S. Grand Ave., Suite 2950
Los Angeles, CA 90071
(213) 996-6136
(213) 576-6070 - Fax
aaron.thomas@aes.com

Theresa Mead
Director of Business Development
AES NewEnergy, Inc.
P.O. Box 65447
Tucson, AZ 85728
(520) 742-7622
Theresa.mead@aes.com

Raymond S. Heyman, Esq.
Roshka Heyman & DeWulf
One Arizona Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85004
(602) 256-6100
rheyman@rhd-law.com

Michael W. Patten
Roshka, Heyman & DeWulf
One Arizona Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85004
(602) 256-6100
mpatten@rhd-law.com

John Wallace
Director of Regulatory and Strategic Services
Grand Canyon State Electric Cooperative
Association
120 North 44th Street
Phoenix, AZ 85034
(602) 286-6925
(602) 286-6932 - Fax
jwallace@gcseca.org

Joan Walker-Ratliff
Manager, Regulatory Affairs
Conoco Gas and Power
1000 South Pine
P.O. Box 1267 125-4 ST
Ponca City, OK 74602
Phone: (580) 767-4070
Fax: (580) 767-5764
joan.walker-ratliff@conoco.com

Lori Glover
Director of Industry Affairs
Stirling Energy Systems
2920 E. Camelback Rd, Suite #150
Phoenix, AZ 85016
Phone: (602) 957-1818
Fax: (602) 957-1919
lglover@stirlingenergy.com

A.B. Baardson
NORDIC POWER
6464 N. Desert Breeze Court
Tucson, AZ. 85750-0846

William Baker
Electrical District No. 6
7310 N 16th Street, Suite 320
Phoenix, Arizona 85020

Paul W. Taylor
R W BECK, Inc.
14635 N. Kierland Blvd, Suite 130
Scottsdale, Arizona 85254-2769

Christopher Hitchcock
Hitchcock & Hicks
P.O. Box 87
Bisbee, Arizona 85603
Phone: (520) 432-2279
Fax: (520) 432-5152
lawyers@bisbeelaw.com

Aaron Thomas
Vice President
AES NewEnergy Inc.
350 S. Grand Ave., Suite 2950
Los Angeles, CA 90071
(213) 996-6136
(213) 576-6070 – Fax
aaron.thomas@aes.com

Theresa Mead
Director of Business Development
AES NewEnergy, Inc.
P.O. Box 65447
Tucson, AZ 85728
(520) 742-7622
Theresa.mead@aes.com

Raymond S. Heyman, Esq.
Roshka Heyman & DeWulf
One Arizona Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85004
(602) 256-6100
rheyman@rhd-law.com

Michael W. Patten
Roshka, Heyman & DeWulf
One Arizona Center
400 E. Van Buren, Suite 800
Phoenix, AZ 85004
(602) 256-6100
mpatten@rhd-law.com

John Wallace
Director of Regulatory and Strategic Services
Grand Canyon State Electric Cooperative Association
120 North 44th Street
Phoenix, AZ 85034
(602) 286-6925
(602) 286-6932 – Fax
jwallace@gcseca.org

Jana Van Ness/Sharon Madden
APS
602-250-2310
Sharon.madden@aps.com

Joan Walker-Ratliff
Manager, Regulatory Affairs
Conoco Gas and Power
1000 South Pine
P.O. Box 1267 125-4 ST
Ponca City, OK 74602
Phone: (580) 767-4070
Fax: (580) 767-5764
Joan.walker-ratliff@conoco.com

Lori Glover
Director of Industry Affairs
Stirling Energy Systems
2920 E. Camelback Rd, Suite #150
Phoenix, AZ 85016
Phone: (602) 957-1818
Fax: (602) 957-1919
lglover@stirlingenergy.com

Christopher Hitchcock
Hitchcock & Hicks
P.O. Box 87
Bisbee, Arizona 85603
Phone: (520) 432-2279
Fax: (520) 432-5152
lawyers@bisbeelaw.com